EVILS OF THE SUB-TREASURY SYSTEM.

FIFTY years ago the mention of government deposits would probably have thrown every household into heated controversy; but to-day it is doubtful whether many persons, outside of those who have dealings with the banks, even know where or how the surplus balances of the United States are kept. And yet this question is of more financial importance now than ever before.

The first United States Bank was used as a depository, but in 1816, in the second United States Bank charter, the first legislation was enacted making this institution a depository. Before that time, and after 1833, when Jackson removed the public funds, the various State banks were also used. The crisis of 1814, as well as that of 1837, brought ruin to the State banks and consequent loss to the Treasury as their chief depositor. How the question got into politics in Jackson's day is a matter of history known to all. Finally, a divorce of banks and state was effected in 1840, but repealed in 1841; then in the years when public attention was drawn to Texas and the Mexican war, the Independent Treasury act was reënacted, in 1846, and has since remained in force.* The system, as created in 1846, has been since but slightly modified, and then not until the exigencies of the first war loan, in 1861, brought about a change by which deposits could again be placed in certain State banks. It will be remembered that only institutions chartered

* Act August 6, 1846. Sections 1, 2, 3, and 4 (and subsequent acts) established as the Treasury the rooms in the new Treasury building at Washington and the rooms and vaults in various places of deposit. Sec. 6: "That the Treasurer of the United States . . and all public officers of whatsoever character be and they are hereby required to keep safely, without loaning, using, depositing in banks, . . all the public money collected by them . . till the same is ordered . . to be transferred or paid out." Sections 18 and 19 provided that after January 1, 1847, all sums due to, or disbursed by, the United States should be paid in gold or silver coin, or treasury notes.

under the various State laws, and so known as "State banks," existed from 1837 to 1864. The commercial depression which followed Lincoln's election and the secession of the Southern States left business in an unsettled condition and obliged the banks to use every means to retain specie in their reserves. The first loan act of July, 1861, proposed the sale of long bonds, running for twenty years (the "sixes of 1881"); but the public were not in a position to take them rapidly, and sales were unfortunately slow. Very patriotically, the banks of New York, Boston, and Philadelphia subscribed for $150,000,000 of these bonds, provided the Treasury would not require coin of them. If, under the terms of the act of 1846, they must make payment in gold or silver, it would be impossible to take the bonds; consequently, it was arranged so that the coin which the banks would otherwise pay for the bonds should be left by the Government with the banks in the shape of deposits,* in the expectation that the public would absorb the bonds offered for sale and that proceeds from these sales would come in as fast as the Government would probably draw on its coin deposits. This was the explanation of the change in the Sub-Treasury system made in 1861.

Only one other change took place, and that consequent on the organization of the national banks in 1864; but it indicates a very considerable departure from the policy of 1846, which demanded a total separation of the Treasury from the banks. In fact, the establishment of the national banking system, by which the Government authorizes and oversees the issues of notes, stands forth in marked contrast with the legislation of 1846, by which the Treasury was withdrawn entirely from any connection with the banks or the money market. The act of June 3, 1864, put it within the power of the Secretary of the Treasury to designate certain of the national banks as depositaries of public funds. But this law, in force to-day, makes a curious distinction between different kinds of Government moneys: it forbids that "receipts from customs" should go into

* Act August 5, 1861: Sec. 6.—"And be it further enacted, that the provisions of the act . . passed August six, eighteen hundred and forty-six, be and the same are hereby suspended, so far as to allow the Secretary of the Treasury to deposit any of the moneys obtained on any of the loans now authorized by law, to the credit of the Treasurer of the United States, in such solvent specie-paying banks as he may select." . .

any national bank depositary; but, at the same time, permits these institutions to receive from collectors any other dues to the United States, such as internal revenues, and after giving proper security hold them on deposit.* As if one kind of state money was good and could be trusted away from home, and another kind was bad and could not.

Such being, in brief, the history of this part of our fiscal system, when it is proposed to study its operations within the last few years, some very striking evidences of growth are to be found. In the days when the debt was insignificant, and the operations of the Treasury comparatively small, the withdrawal of Government funds from the money market produced no difficulties; but, with the extension of fiscal movements from small sums to hundreds of millions, the present policy of the Government, taken in connection with modern banking methods, becomes one of vast practical importance.

The chief objection to the independent treasury system of to-day is that it has been outgrown by the country; that it is economically wasteful in proportion to the magnitude of its dealings; and that, by its effects on the reserves of the banks, it is becoming dangerous to the banking and business public. In order to show this, it will be necessary to explain, as briefly as possible, some of the operations which go on in the banks. A might be a borrower at a bank. The resources-side of the account shows an increase of loans by the amount of the securities received to secure the loans; but if checks on the bank are more convenient, and are received by every one to whom he makes payment, what need has A of actual money for his loan? He is, therefore, at once credited with a deposit to the amount of his loan, or, in fact, borrows the right to draw a check on a deposit placed to his credit. Then the disposition

* SEC. 45. "And be it further enacted, that all associations under this act, when designated for that purpose by the Secretary of the Treasury, shall be depositaries of public money, except receipts from customs, under such regulations as may be prescribed by the Secretary. . . . And the Secretary of the Treasury shall require of the associations thus designated satisfactory security, by the deposit of United States bonds and otherwise, for the safe-keeping and prompt payment of the public money deposited with them. . . . Provided, that every association which shall be selected . . . shall take and receive at par all of the national currency bills, by whatever association issued, which have been paid in to the Government for internal revenue or for loans or stocks."

to draw actual cash depends on considerations which do not affect our inquiry, such as the soundness of the institution, or a general disturbance of credit. It will be seen, then, that in nearly exact proportion to the use of checks and deposits in a community will there be a close relation between loans and deposits. To make it absolutely clear that in great financial centers this system of checks is really in use, the following figures are taken from national bank receipts in the United States on one given day, June 30, 1881:

Location.	No. of Banks.	Total Receipts.	Proportions of Gold Coin. %	Silver Coin. %	Paper Currency. %	Checks, Drafts, etc. %
New York City........	48	167,437,759	0.27	0.01	1.02	98.70
Other Reserve cities..	187	77,100,715	0.76	0.15	4.71	94.38
Country banks........	1731	40,175,542	2.04	0.77	15.47	81.72
United States.........	1966	284,714,016	0.65	0.16	4.06	95.13

This shows that ninety-five per cent. of all transactions with the national banks of the United States are effected without the use of actual cash. To this extraordinary extent have credit devices succeeded in bringing us to a civilized method of barter, by which goods are actually exchanged against each other without the transfer of money.* In country districts, however, this is less true. Still, this highly sensitive mechanism is the product of the last few decades, and is wholly the outgrowth of modern credit and business. The increase between 1871 and 1881 is very striking, as seen in the operations of the national banks:

	1871.	1881.
Capital..................	$458,000,000	$464,000,000
Deposits.................	631,000,000	1,083,000,000
Circulation..............	317,000,000	320,000,000

While "capital" and "circulation" remained very nearly stationary, credit liabilities, or "deposits," increased about seventy per cent. and saved the actual use of money to that amount.

* The same truths are illustrated by returns on a given day from London and provincial banks in England.

The connection of this with the Treasury will soon be evident. Recall (1) that an increase of loans increases deposits, or demand liabilities, and (2) that the means by which demand liabilities are met consists of the cash reserve. Yet, in the mere act of making a loan, nothing has taken place which increases the cash reserve. Moreover, the ability to loan depends on the relation of the cash reserve to the immediate liabilities, that is, practically, to the deposits.

Anything, therefore, which changes the amount of the cash reserve vitally affects the loaning power of all the banks. But it so happens that the national banks are obliged by law to keep either coin or legal tender notes in their reserves; therefore, our inquiry need only follow the movements of coin or greenbacks. At a given time, the amount of cash in the community is a definite quantity, and the conditions of business and exchange determine how much is to be left in the banks. When trade is going on regularly, it has, *ipso facto,* reached a settlement of those relations in accordance with commercial needs. After the adjustment has been made, if there is a greater demand for loans than the banks of one city can supply, the higher rate of interest there attracts deposits from other places or, *mutatis mutandis,* from other countries. Whenever gold is drawn from New York to London, the banks are touched at a vital point. Certain business houses wish to pay gold to persons in London, and so draw on their deposit accounts in the banks for the amount of the intended shipment, thereby lessening the cash reserves to the same amount but in a far greater proportion,—since a given sum is a larger percentage of the smaller of two quantities. Then, if the banks cannot replenish their stock, eventually they must do one very hazardous thing—a resource tried only in a last extremity—refuse to loan. But that means commercial distress in every branch of business, a rich crop of failures, and the old story of a panic. This, as explained, is what happens when gold goes abroad. But this also is what happens when gold is withdrawn from the banks in any other way. Suddenly carry the gold to London; sink it in the sea; or hide it from sight in the vaults of an independent treasury, and the effects on business will be precisely the same. Here, then, is the sin of the Sub-Treasury system against the business interests of the country. To begin with, the revenues of the United States are coming in faster than they can be

applied to the expenses of the Government and the payment of the national debt. The tariff is still practically on a war basis, and is giving us war revenues in times of peace. The customs show, consequently, the greatest increase, and, in fact, within the last four years they have nearly doubled.* Then it is also to be remembered that, during the war and the depreciation of government paper, because the country had agreed to pay the interest (and, later, the principal) of its debt in coin, it was found necessary to secure a regular supply of specie. So it was required by law that no other money than coin should be received for duties on imported goods. Consequently, as the amount of these duties increases, there will always be an increased demand from importing houses for specie with which to pay the Treasury. But this coin is got in the same way as when shipments are made to Europe: these houses draw on their deposits for the money and take it from the reserves of the banks. Then the captive specie mournfully descends into the dark vaults of the Government sub-treasuries. There is no difference, except in the incident of destination, between this operation and sending it over the ocean. This wrong, as mentioned before, is accomplished by the act of June 3, 1864, which forbids the deposit in the designated banks of any sums which are received in payment of customs. The measure was adopted when greenbacks were below par, and consequently has no justification in the present changed conditions of the currency.

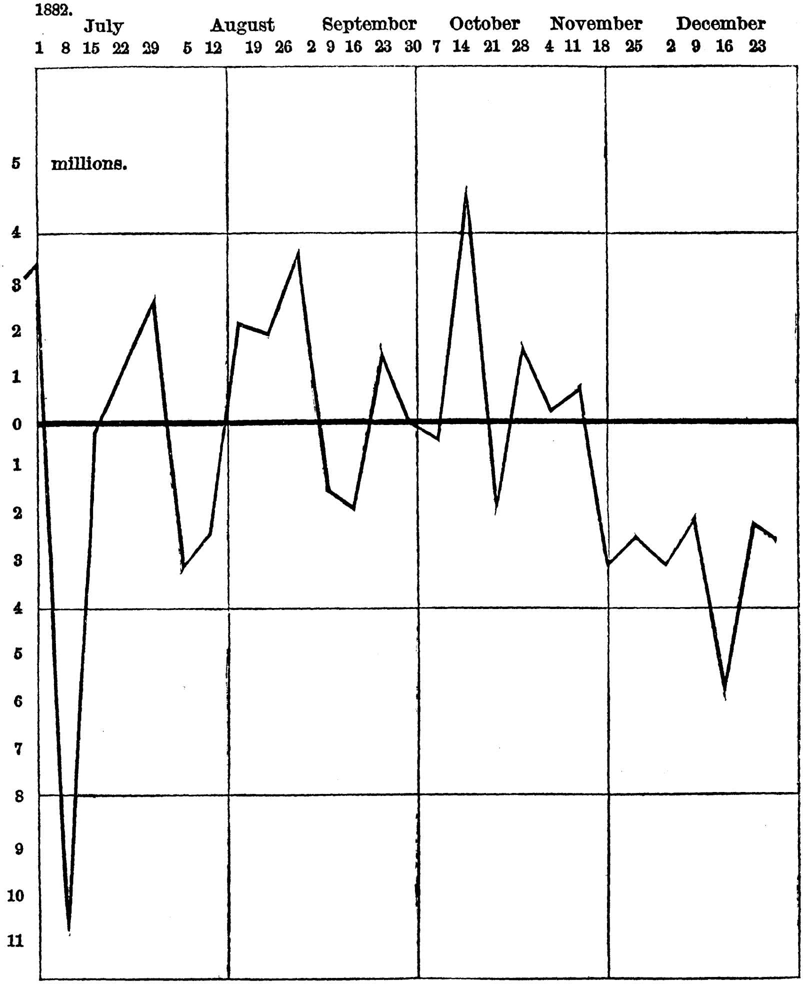
But why does the coin not come out of the Treasury, after it goes in? The Secretary can pay out funds only on appropriations of Congress for certain purposes, such as for pensions, for interest on the public debt, or for the principal of such obligations as have matured. In case the expenditures were met in exact proportion to the incoming flow of specie, the funds would go back to the banks. But from the very nature of Treasury payments this cannot be true. In calling in matured bonds it is necessary to give three months' notice before interest ceases,

* Sums are given in millions and tenths of millions.

Year.	*Dutiable Mdse. Imported.*	*Customs Received.*	*Internal Revenue.*	*Reduction of Debt.*
1879	......$296.7	$137.2	$113.9	6.8
1880	...... 419.5	186.5	124.5	65.8
1881	...... 448.0	198.1	135.8	100.0
1882	...... 514.0	220.4	146.5	166.2

so that the Secretary is obliged to forecast with precision three months ahead, and be certain that his surplus is sufficient for the call. Hence, even if the called bonds all came in when interest ceased, the specie must remain for a considerable time out of reach in the Government vaults. But, in point of fact, it is found that a considerable proportion of the bonds are not sent in when called and, therefore, specie to the full amount of the call cannot be sent forth. Payments for interest, or pensions, moreover, are at still longer intervals than those for matured bonds. But every day and week coin is withdrawn from reserves by importers to be turned over to the Government for customs duties, while the gates of the Treasury are only opened at considerable intervals. The bad effects are felt daily; the relief comes, perhaps, monthly or at longer periods. To show with what rapid and very exasperating jerks the system has worked, a table and a chart have been prepared which illustrate the actual operations for the last six months of 1882:

1882. *Week ending*		*Specie withdrawn by Sub-Treasury.*	*Specie let out by Sub-Treasury.*
July	1	$3,500,000	......
"	8	......	$10,900,000
"	15	......	300,000
"	22	900,000	......
"	29	2,500,000	......
August	5	......	3,100,000
"	12	......	2,300,000
"	19	2,000,000	......
"	26	1,800,000	......
Sept.	2	3,700,000	......
"	9	......	1,400,000
"	16	......	1,800,000
"	23	1,400,000	......
"	30	......	30,000
October	7	......	300,000
"	14	4,800,000	......
"	21	......	1,900,000
"	28	1,500,000	......
Nov.	4	200,000	......
"	11	700,000	......
"	18	......	3,000,000
"	25	......	2,400,000
Dec.	2	......	3,000,000
"	9	......	2,000,000
"	16	......	5,800,000
"	23	......	2,100,000



The movement of the line above 0 shows the flow of specie from the reserves of the banks into the Treasury and, below 0, the flow out of the Treasury back to the banks.

Moreover, since the return of specie from the Treasury is awaited with anxiety, all things depend on the intentions of the Secretary. The extent to which the finance minister of this country holds it in his power to ruin or extend credit is already a dangerous thing to contemplate. He is master of the monetary

situation. The irregular jerkings of the Treasury movements add fuel to speculation. If much specie has gone into the Treasury, speculators can withdraw more, and "squeeze the market." It is, therefore, possible for the Secretary to affect the money market, and thereby the fortunes of men, throughout the whole country. It is a power which ought never to be given to any man; and yet it is the highest evidence of the integrity and character of this official that he has never been suspected of such action, and that this argument against the present system is, of all, the least important.

The administration of our Treasury balances has great and serious defects. At present, it acts like a highway robber who shuts his fingers tightly around a man's throat until breathing is cut off, and then lets go until the victim has recovered sufficiently to give the ruffian the pleasure of repeating the process. He would be a very mild-tempered man, indeed, who simply arose and went on his way, remarking that such treatment is occasionally very inconvenient. The nature of the evil, however, does not seem to be clearly understood, for we are told that a reason for reducing taxation is the difficulty under which the Treasury labors of releasing its surplus funds. By this theory, the matter is to be settled, not by studying an improved system of fiscal administration, but by avoiding the issue through a removal of the special and temporary cause of the difficulty. This is not high statesmanship, but it is the position of our present Secretary of the Treasury in his report of December, 1882 (p. xxviii). After discussing the question, he says: "For these reasons I would not seek a release of the Treasury from this complication, in these modes [*i. e.*, by depositing in banks]. The radical cure for the evil is in the reduction of taxation. . . . The evil comes from the likelihood of the Government holding from time to time a large surplus to be poured out in volume at uncertain and unforeseen times, and at times often inopportune for the business of the country. There could not be that surplus . . if the subjects of taxation were lessened."

The principle of this policy is exactly that of an employer who, once finding a clerk in the act of stealing money from his safe, good-naturedly refused to discharge him; but adopted the ingenious plan of reducing the extent of his business in order that no surplus might be left in his safe as a temptation to a poor fellow who was a trifle weak in his character. Common sense would suggest that this temporary expedient for freeing

the thief from temptation was dearly bought at the expense of reducing the volume of the employer's transactions, especially when he was heavily in debt and wanted to clear himself from this burden in a prosperous season. Surely this reasoning of the Secretary is most extraordinary. Taxation is supposed to be levied in proportion to the expenditures of the state, and not raised or lowered on account of the difficulties in fiscal administration by which the money is received or paid out.

The present Sub-Treasury system, moreover, is bad for another reason, founded wholly on fact. In May and June, 1881, about six hundred millions of five per cent. and six per cent. bonds fell due, and were extended at three and one-half per cent., on condition that they might be paid off whenever the revenues gave a surplus. And they have been rapidly paid; indeed, it is owing to the possibility of paying them off that the Secretary has been able to let out specie from his vaults in such amounts as have greatly lessened the evils of the present system. The ordinary payments for interest alone would have released but a fraction of the stream of specie daily flowing into the "bourne" from which no traveling specie ever easily returns. Had no payments been made for bonds, there would have been an increased pressure put upon the bank reserves. It would have been like a continued stoppage of the breath; strangulation would have taken place in the financial organism; and if no help had come from abroad, or elsewhere, we should soon have had a body without breath, a financial corpse, *i. e.*, a panic. But, if this would have happened had there been no bonds to be paid off in these last months, it is exactly what will happen in the near future, unless some change is made. If our present surplus continues, it is estimated that by June, 1886, all the bonds redeemable at the pleasure of the Government will have been paid. Then what? No other bonds, unfortunately, become due until 1891; so that in less than three years we ought not, forsooth, to have a surplus from revenues, because the specie will be withdrawn from business. In two or three years, then, the Sub-Treasury system will be as troublesome as ever, even if taxation is reduced. Or, to return to our illustration, the dishonest clerk will begin to filch again, if he is retained in his position.

Thus, as fully as the limits of this paper would permit, the history of the present system, its workings, and the evils attaching to it have been given, and it may well be asked now what

remedy is proposed? It is easy to destroy, not so easy to construct. In taking up this part of the question, it must be asked, first, what has financial experience in other countries to teach us? France keeps her balances in the Bank of France, and rather aims to correct than to interfere with the money market. England has no treasury, but collects and disburses all her funds through the Bank of England, without taking one shilling from the borrowing public. We have, it is true, no Bank of France or Bank of England, but we have in the national bank system the best the country ever enjoyed. By the act of 1864,* they are made possible depositaries, and are now used as such for that part of the Government revenues which is collected by internal taxation. The machinery for a reform, therefore, is already in existence, and suggested by the act of 1864. Yet the question of a remedy is to be settled, as in the case of a disease, by the explanation of the evils. It is not generally realized that, like the Bank of England, the Clearing House Association of New York is the center and pivot of the banking system of the country. The country and city banks keep a large part of their reserves in the New York banks, and, as every banker knows, this fact makes the latter the heart of the whole system; and naturally, too, for New York is the place where the largest exchanges of goods take place and where credits and loans are most demanded. To the condition of the reserves in the banks of New York every one now, as a fact, looks when it is desirable to mark the effect of shipments of specie abroad, or of withdrawals by the Treasury. Consequently, these banks must be parties to any arrangement by which the evils of such withdrawals may be avoided. It is the reserves of the New York banks which must be protected from sudden drains. They are, therefore, by the very facts of trade and banking in this country, marked out as the proper agents of the Government in the proposed fiscal reform. But, say objectors, the security of the Government funds becomes involved in that of these banks, and, in case of a commercial crisis, the Treasury would be unable to get at its funds and could not meet its daily demands. That this happened in the years after the panic of 1837–9, before the passage of the Sub-Treasury act, is true. Therefore, let the Government, if it should deposit with these banks, exact a security,—and for the present it would be

* *Vide* note, page 554.

best to have this in the shape of its own obligations or bonds. It does this already in regard to internal revenue. And then there is nothing to prevent the Government from keeping a little sum in its own vaults as provision against a rainy day. But its own bonds would furnish an absolute security, because, in this case, they are the very obligations for the payment of which the surplus funds are collected by taxation and deposited in the banks.

There is actually no reason in using the fear of a panic against a system of deposit with the banks. As a matter of fact, it is proposed to set apart a special part of the bank resources as a pledge for the payment of that one liability known as "Government deposits." But this is exactly what has been done in the case of issues by the national banks, and it need hardly be asked whether one cent has ever been lost by holding a note of these institutions in the crisis of 1873. No one ever did lose; and there is less reason that the Government should ever lose by the proposed plan. But would the banks take these deposits? Yes, readily, and even pay one or two per cent. interest, a sum which would be a clear gain to the Government, because as long as the specie remains in its own vaults it returns absolutely nothing. The holding of Government balances is, as every banker knows, a most valuable privilege,—simply because, under the modern system of credit, banks derive their chief income from the ability to loan the money left with them on deposit. In the case of funds intrusted to them by private persons, they are enabled, as experience shows, to loan perhaps two-thirds, and yet have in the remaining one-third a reserve sufficient to meet daily demands from these depositors; but in the case of Government deposits, not only are the amounts large, but bankers can know, through the publicity given to Treasury operations, exactly when sums fall due and how long the money is to be left with them. Consequently, the element of uncertainty existing in regard to private deposits is reduced to a minimum, and a larger proportion of public deposits can be loaned. But the argument for the change ought not to be based on the small profit either to the banks or to the Government, but on the necessities arising from the condition of modern trade, and the connection of the Treasury operations with the money market. Even if it cost the Government something, it would yet be desirable.

It is true that, if a security of United States bonds is adopted, the plan cannot be any more permanent than the system by which national bank issues are secured. But the suggestion affects the Sub-Treasury operations differently from the way in which it affects the issues of national banks. When the United States bonds are paid off and disappear, other securities must be devised for the note issues, or the national banks must cease to exist; but in the case of security for deposits of Government funds, when our bonds are paid, there will be no reason for the existence of Government deposits to any extent, since there ought to be no surplus to deposit. The Federal Government has no right to collect more than it expends just for the fun of it, or for the silly purpose of dividing it among the States.

J. LAURENCE LAUGHLIN.